Department of Foreign Affairs
and International Trade

Ministère des Affaires étrangères
et du Commerce international

CANADA

THE CONFLICT OF TWO REALITIES AND TWO VIEWS:

A COMPARATIVE ASSESSMENT OF THE CANADIAN AND AMERICAN FILM INDUSTRIES

by

Rebecca Goldfarb
The 1997-1998 Norman Robertson Fellow

The Trade and Economic Analysis Division (EET)
Department of Foreign Affairs and International Trade

September 1998

Reference Document No. 5

The Department of Foreign Affairs and International Trade

REFERENCE DOCUMENT NO. 5

THE CONFLICT OF TWO REALITIES AND TWO VIEWS:

A COMPARATIVE ASSESSMENT OF THE CANADIAN AND AMERICAN FILM INDUSTRIES

by

Rebecca Goldfarb
The 1997-1998 Norman Robertson Fellow

Trade and Economic Analysis Division (EET)
Department of Foreign Affairs and International Trade

(September 1998)

The Conflict of Two Realities and Two Views: A Comparative Assessment of the Canadian and American Film Industries, by Rebecca Goldfarb, Government of Canada© (Department of Foreign Affairs and International Trade Canada) 1998. The views expressed are those of the author and not necessarily those of the Government of Canada. Comments or enquiries should be addressed to the author.

ISBN 0-662-27087-8
Cat. No. E73-16/5-1998E

TABLE OF CONTENTS

Executive Summary 3

I. The Debate about Trade and Culture: The Canadian and American Views 5

II. The International Environment 8

A: The Global Film Industry and the Domination of Hollywood 8

B: An Overview of Trade and Investment Agreements' Implications for the Film Industry 10

- i) The World Trade Organization 11
- ii) The FTA and the NAFTA 13
- iii) The MAI 14
- iv) The Challenges Imposed by Global Trade and Investment Agreements 15

C: The Other Challenges of Globalization 17

- i) The Technological Challenge 17
- ii) The Commercial Challenge 18
- iii) Meeting the Global Challenges 19

III. Two Distinct Industries Facing Different Global Realities 21

A: The Canadian Industry 21
- i) Canadian Support Measures 21
- ii) Production 24
- iii) Distribution 25
- iv) Exhibition 28
- v) Canadian Policy Direction in light of International Obligations 30

B: The United States Industry 31
- i) United States Support Measures? 32
- ii) Production 36
- iii) Distribution and Exhibition 37
- iv) Vertical Integration and Anti-Trust 39
- v) Impact of the United States Industry on Canadian Policy 41

Bibliography 43

EXECUTIVE SUMMARY

This paper briefly reviews the debate about trade and culture in the context of film. The word culture has caused tensions in the Canada-United States relationship because of the difference between what Canadians term "cultural industries" and what the Americans call "entertainment industries." In Canada and the United States, there are diverging views over the justification for support for the "cultural industries" in general, and for film policy in particular due to the unique character of this industry. These diverging attitudes have resulted not only in different views as to how trade and investment agreements should address this sector, which is the focus of this study, but also in the structure of the industries in both countries.

The film industry is, and always has been, international in both production and distribution. In other words, big successes are usually achieved not only in the domestic market, but also in the global market. The United States has dominated this industry since the early days. It is argued that Hollywood's success results from the fact that producers rarely make films only for the home market, but for the world. The argument follows that others could also succeed if they too perceived the market as global. While this argument has some merits, it does not fully explain why film industries in other countries have not had the same success as Hollywood. The global economic environment creates a different reality for most countries. The small country argument has been that producers cannot afford as expensive production budgets as the United States because the domestic markets in which their programs are sold are more limited. However, it is questionable whether or not this argument provides a complete answer. A language argument is often made which is similar to the small country argument.

While the reasons for United States success in this sector are not always obvious, it is clear that the overwhelming presence of the United States in the cultural or entertainment industries encourages other countries to develop regulatory measures, tax incentives and subsidies to develop domestic film industries. Such policies are justified on political and cultural grounds but have led to international ramifications, including ones in the area of international trade.

The Canadian term "cultural industries" and the American term "entertainment industries" reflect different choices in the way in which both countries understand the issue and/or want to convey their position. This difference has resulted in conflict between Canada and the United States in recent years. The Canadian view is that the issue must have maximum flexibility to continue and implement measures that preserve a space in Canada for Canadian products. The American view is that by requiring flexibility, or the ability to take exceptions to international obligations, Canada is discriminating against United States' entertainment products. These different attitudes have resulted in different opinions about how culture should be treated at the World Trade Organization (WTO), in the North American Free Trade Agreement (NAFTA), and in the Multilateral Agreement on Investment (MAI). Some of the obligations that have resulted from these negotiated agreements have challenged Canada's support measures notwithstanding the exceptions on special provisions. Canada should find the best means to address these international challenges. In order to undertake them, Canada will have to start by

formulating realistic domestic objectives. The resulting policies will have to differentiate between cultural and industrial goals.

The global challenges facing the cultural industries do not only result from international trade and investment obligations. Technology will continue to re-invent the entertainment industry, and Canada must also respond to these changes. The commercial challenges presented by Hollywood's global strength are significant for Canada and most other countries; however, the economic reality of the global entertainment market cannot easily be altered. Canadian policy-makers must understand these constraints and develop both realistic objectives and means for achieving them. Canadian policies must be relevant in the new and evolving global entertainment environment.

The Canadian cultural industries are characterized by a considerable amount of government intervention. This role of government must be reviewed in light of the changing legal, technological, and economic framework -both domestic and international- in which Canada operates. Canadian support measures include tax incentives, direct investment, and support for international co-productions. With respect to production, the challenge for Canada has been that despite an increasingly large production industry, few of the films that are made succeed in the domestic feature film market. Generally, these production problems are considered to be connected to distribution. It is argued that film distribution is central for the industry because revenues earned from distribution generate more funds for production in Canada. This thesis needs to be re-examined both because few Canadian films are available in theatres and because this policy appears to have industrial goals as well as cultural ones. The challenge for Canada is developing a cultural policy that allows for more Canadian content in production, but that does not have industrial or international trade implications that could be challenged by Canada's trading partners.

The United States visual media industry presents many challenges to Canadian policy. The U.S. visual media industry (film, video, and television) generates about $18 billion in foreign revenues annually. The Americans also have recognized the economic and non-economic benefits of the film industry. Distribution and exhibition have been complicated in the United States due to the non-competitive practices of the major studios. Currently, the trend is towards vertical integration. This trend reflects the changing nature of the global industry. While the structure of the United States industry has enabled it to succeed on a global basis, it has perhaps also made it difficult for new entrants, both domestic and foreign, in the United States market.

At the international level, Canada must determine what is the appropriate level of flexibility. Given that the United States will continue to oppose cultural protection measures, that more and more Canadians seek to export films, that rules create a framework within which to operate, and that in most other sectors Canada has supported rules, Canada will have to negotiate mutually agreeable international norms and rules for culture. This will necessitate defining on an international basis what exactly are cultural industries. Since this process will likely take place in existing international fora, Canada must be ready to participate. This does not negate the

prospect of Canada negotiating a separate agreement on culture. However, such an agreement cannot be inconsistent with rules that likely will be formulated in the WTO.

I: THE DEBATE ABOUT TRADE AND CULTURE: THE CANADIAN AND AMERICAN VIEWS

The word culture has caused tension for many years in Canada-United States relations. What the Canadians refer to as cultural industries is what the Americans call entertainment industries. The complexity of the word is illustrated in Pierre Berton's *Why We Act Like Canadians*. In this book Berton informs Uncle Sam about Canadian culture in a series of letters. In one such letter Berton tells Uncle Sam:

> As for culture we [Canadians and Americans] don't speak the same language. You think of culture in terms of opera, ballet, and classical music. To us it covers everything from Stompin' Tom Connors to Hockey Night in Canada. What is merely "industry" to you is culture to us. Books, magazines, movies, radio, television - all culture. Anne Murray is culture . . . Maclean's Magazine is culture. The government subsidizes them all, in one way or another, because all are genuine Canadian artifacts, distinct and unique, something that nobody else has - the ingredients of our national mucilage.[1]

This paper will focus on Canada and the United States. This does not mean that this issue is uniquely a Canada-United States issue. The concept of culture is elusive and as a result there are wide-ranging definitions of the term. This lack of agreement has resulted in a debate about where culture ends and where industry or entertainment begins. This topic has generated new interest around the globe. Trade in the audiovisual sector was a major stumbling block at the end of the Uruguay Round. As a result of the differences in views between the Europeans and the Americans, the audiovisual sector was not addressed in the WTO's General Agreement on Trade in Services (GATS), the first-ever comprehensive agreement on services. Europeans, like Canadians, believed that certain policy measures, both domestic and international, were necessary to support the domestic industry in this sector.[2]

The government of Canada has declared that culture is a unique industry. The Liberal government states that, "Canadian culture embraces our shared perceptions and beliefs, common experiences and values, and diverse linguistic and cultural identities. Culture is the very essence

---

[1] Pierre Berton, "The Puzzle of Free Trade," in *Why We Act Like Canadians: A Personal Exploration of Our National Character* (Markham, Ontario: McClelland and Stewart, 1987), 9.

[2] Rebecca Goldfarb, *Canadian Protection and Promotion of Broadcasting: A Public Policy Constrained by Global Realities (doctoral thesis)*, November 1997.

of national identity, the bedrock of national sovereignty and national pride."[3] The Department of Canadian Heritage (DCH) states that "culture is not just a product, a commodity, or a service that is bought and sold in the market place."[4] As a result of the special nature of culture, Canada fought hard for the cultural exemption in the Canada-US Free Trade Agreement (FTA) and NAFTA, and for non-applicability under the GATS in the WTO.

While culture, in Canada, is seen as different from other products, commodities, or services, there is a clear understanding that cultural goods also produce industrial benefits. The Department of Canadian Heritage (DCH) also states that "the cultural sector is unique because it can deliver on both unity and jobs."[5] However, job creation seems outside the parameters of a policy intended for simply a "cultural" benefit. Policies intended to create jobs are usually equated with industrial policy. Industrial policy constitutes a government's "explicit attempt to coordinate its own multifarious activities and expenditures and to reform them using as a basic criterion the achievement of dynamic comparative advantage."[6] Chalmers Johnson states that "industrial policy is a summary term for the activities of governments that are intended to develop or retrench various industries in a national economy in order to maintain global competitiveness."[7] Therefore, according to DCH's own broad objectives, Canadian support mechanisms for the cultural industries are industrial as well as cultural.

Increasingly, the problem for Canada, and for other countries concerned about this matter, is that the United States does not accept the argument that culture constitutes a unique industry; rather, Americans perceive culture to be a good or service, like any other good and service sold either domestically or in world markets. They therefore see Canadian public policy as more industrial than cultural. The problem for the United States is the impact of Canadian policy, whether industrial, cultural or both, on its trade and investment relations both with respect to Canada and as "documentation effect" factor with respect to other countries.

This difference in perception about whether the support for the cultural industries is justified because of the unique character of the industry has resulted not only in differences about how trade and investment agreements should address this sector, but also in the structure of this sector in both Canada and the United States. In Canada, there is significantly more government involvement than in the United States. These differing points of view on the cultural industries

---

[3] Department of Canadian Heritage. *Contribution of the Cultural Sector to Employment and Economic Growth*,October 31, 1996, 2. (unpublished document)

[4] Ibid.

[5] Ibid.

[6] Chalmers Johnson, "Introduction: The Idea of Industrial Policy," in*The Industrial Policy Debate*, ed. Chalmers Johnson (San Francisco: ICS Press, 1984), 7.

[7] Ibid.

and the role of governments clearly are linked to broader cultural differences including different conceptions of the appropriate role of government in our societies.

Indeed, although industrial and cultural policies exist in both Canada and the United States, both nations' approaches are different. Canadians generally favour more government intervention than Americans. Canadians, or at least the cultural elite, believe that government involvement in the cultural sector can create positive cultural and industrial results. The United States generally sees the government role as much more limited. These philosophical differences likely relate to the fact that the American approach is appropriate for a dominant economic and political power, as well as for a state formulated on a basic distrust of government. Canada's approach is appropriate for a smaller nation born and evolving in the shadows of a much larger power.

Although the cultural industries include broadcasting, film, sound recording and publishing, this paper will focus on the feature film industry. The second section will review the international agreements that establishes rights and obligations for both countries with respect to the feature film industry. The third section will demonstrate that different domestic industries create an international environment where Canada is more challenged to rethink its domestic approach. Nonetheless, any new approach must take into account Canada's current and future international obligations, while acknowledging and addressing Canada's domestic objectives.

II: THE INTERNATIONAL ENVIRONMENT

A: The Global Film Industry and the Domination of Hollywood

The film industry consists of three sectors: cinema, video and television. This paper focuses on cinema or "first run films." Keith Acheson and Christopher Maule argue that the film industry is, and always has been, international in both production and distribution.[8] The United States has dominated the global film industry since its early days. They contend that American producers did not make films or television programs just for the home market, but for the world. Of the $23 billion in global sales of film products in 1994, 60 per cent was generated by the United States domestic market and 40 per cent by non-American markets, with the European Union constituting approximately just over half of the latter. American-made films account for approximately 80 per cent of gross box office revenues outside the United States and 95 per cent within the United States.[9] The United States benefits from dominating the global market because every country in which the film or program is sold after adjustment for distribution costs, constitutes a net addition to total profits, and thus to a positive US balance of payments. It is worth noting, however, that while the United States dominates the global film industry not all United States producers are owned by American citizens. Sony is Japanese-owned and Universal Pictures is Canadian-owned.

Acheson, Maule and Elizabeth Filleul provide a good description of the economics of the film and television industry. They state:

> The film and television industry is unique in the way economic factors are combined. Like publishing manuscripts, film and television programs are public goods. Like research and development, they involve risk in that, until produced and marketed, there is no way of knowing whether they will be profitable. Like the construction of a dam or factory, they require the combination and organization of an array of skills for a particular project, at the end of which the inputs may disperse to coalesce around other projects in the same or different combinations. And like many other service activities, data on the extent of international trade are poor, in part due to the intangible nature of the traded item and in part to the desire of buyers and sellers for confidentiality."[10]

Acheson, Maule and Filleul further argue:

---

[8] Keith Acheson and Christopher Maule, "Shadows Behind the Scenes: Political Exchange and the Film Industry,"*Millenium Journal of International Studies*, 1991, vol. 20,No.2, 287.

[9] James M. Bedore, "U.S. Film Industry: How Mergers and Acquisitions are Reshaping Distribution Patterns Worldwide,"*Industry, Trade and Technology Review*,17.

[10] Keith Acheson, Christopher Maule and Elizabeth Filleul, "Folly of Quotas on Films and Television Programmes,"*The World Economy*, December 1989, vol.12, no.4, 516.

Producers in small countries argue that they cannot afford as expensive productions as the United States because they expect to sell their programs only in a small market as opposed to the much larger American market. In fact, American producers never made films or television programs just for the American market, but for an even larger international market. Hollywood always thought in terms of international sales, while producers in other countries, such as Canada, planned in terms of the domestic market. An interesting question, therefore, is this: Why did producers in small countries not think globally when the example of Hollywood was there?[11]

This question seems to have a complex answer. While Acheson, Maule and Filleul dismiss the small country argument, they do not show how smaller countries could have countered the American advantage of being an early industry leader, a large producer of film and television programming, and finally a large consumer of these programs. It seems reasonable to assert that the global economic environment creates a different reality for most other countries. The small country argument has been that their producers cannot afford as expensive productions as the United States because the domestic markets in which their programs are sold are more limited. This argument assumes that production expenditure will relate to the size of the domestic market. It also assumes that these expensive productions are required in order achieve success both at home and perhaps abroad. The argument that smaller countries have been unable to achieve success because of size cannot easily be proven or disproved. What is clear is that no small country, or rather no country but for the United States, has been able to gain a large share of the global market for film. Acheson, Maule and Filleul clearly develop the industry leader argument; however, it seems that the size of the United States market was an important factor in United States success.

Language is a factor in determining the size of the global market. India, for example is a large country, with a relatively large film industry; however, production budgets for Hindi language films, are small relative to American budgets. They are small because there is little export potential for a Hindi film. This is not only a problem for Hindi films, but for non-English language films in general. Selling in the American market is extremely difficult because there is a non-acceptance, or a belief among industry players that control distribution channels of a non-acceptance, of dubbed and sub-titled films in the United States. This constitutes a problem because success in the United States market is not only important because of its market size, but because success there virtually guarantees success in other markets.[12]

Even given the small country and/or language arguments, the reasons for the United States' success are not evident. What is clear is that this overwhelming United States domination

---

[11] Ibid

[12] This success is almost guaranteed because of a global perception that if a film succeeds in the hotly competitive United States market then it is a good marketable film. Also, there remains an admiration in many parts of the world of American products and the American way of life.

has encouraged others to develop regulatory measures, tax incentives and subsidies to develop domestic film industries. These regulatory measures are intended to help domestic industry address the fundamental problem of not being able to achieve the required revenues for production. These measures exist because the small country argument carries salience around the globe. Many countries believe that their economic support of the domestic film industry will assist their industries to co-exist with Hollywood. By intervening in the industrial organization of the film industry, public funding in this sector is intended to affect the economic welfare of a country.[13]

Accompanying the economic incentives to foster a film industry and distribute films around the globe, there exists a political or cultural one. Most countries express concern about cultural harmonization and about the need to maintain shelf space for their own products in their own country. These concerns seem to result from the fact that "films disseminate images of desirable behaviour and communal values that have a substantive effect on legitimizing social relations and institutions."[14] Thus, films have a propaganda value to political elite. This non-economic component has resulted in countries wishing to maintain a domestic production industry that has a "national quality." Film as a tool of social cohesion or social engineering then justifies public support of the domestic industry. This non-economic component of the film industry, while not generally associated with the United States industry, is not absent from it. The power of film to communicate values is understood not only in Hollywood, but also by the United States government.

B: An Overview of Trade and Investment Agreements' Implications for the Film Industry

The Canadian term cultural industries and the American term entertainment industries reflect different choices in the way in which both countries understand the issue and/or want to convey their position. This different understanding has resulted in policy conflict between Canada and the United States in recent years. The Canadian view is that it must have maximum flexibility to continue to implement measures that preserve a space in Canada for Canadian product. The American view is that by requiring flexibility for domestic policy-making or by having exceptions in international trade agreements, Canada is discriminating against United States entertainment products. In summary, while Canada seeks special treatment for its cultural industries, the US prefers to apply normal trade agreement obligations.[15]

---

[13] Johnson, 7.

[14] Acheson, Maule, and Filleul, 515.

[15] Centre for Trade Policy and Law, *Trade Policy Sessions Binder*, 1997.

i) The World Trade Organization

The World Trade Organization (WTO) was created out of the GATT Uruguay Round of negotiations in 1994. The traditional focus on trade in goods and the reduction of border impediments, embodied in the original 1947 General Agreement of Tariffs and Trade (GATT), changed significantly with the creation of the WTO. This agreement is the most comprehensive trade agreement ever negotiated; it includes not only goods, but also services, intellectual property and investment.

The original GATT did not contain a cultural exemption. Cultural goods were treated like other industrial products. However, Article IV of the GATT permitted screen quotas for cinematographic films, which was a derogation of the national treatment obligations. Canada did not have screen quotas at this time and cannot impose new ones because Article IV allowed only for existing quotas. Acheson and Maule state:

> This measure was included in recognition of the need to provide for the postwar revival of the film industries in Europe and to ration scarce foreign exchange for the purchase of necessities. Films were considered to be special items in part because they were seen to promote the sale of domestically produced goods and services.[16]

The new WTO General Agreement on Trade in Services (GATS) includes a number of obligations with regard to services. It does not include a cultural exemption clause. Canada, as signatory to the agreement, is obliged by GATS unless it made a reservation or exception in this or other areas. In the GATS, countries can list exemptions to its Most Favoured Nation (MFN) obligations. Market Access and National Treatment obligations only apply to services listed in each country's schedule of GATS commitments.[17] Canada listed a broad MFN exemption for its film and television co-production treaties for an indefinite period of time in its schedule of commitments. The exemption applies to production and distribution. Canada did not make Market Access or National Treatment commitments in the GATS on any cultural sector. In its schedule Canada listed an MFN exemption for film co-productions. Further, it declined to undertake market access and national treatment obligations for the audiovisual sector.

The negotiations in the audiovisual sector were contentious during the Uruguay Round. The term "audiovisual services" is the technical name used in international trade negotiations to discuss film, music, broadcasting rights, project services and other production and distribution services dealing with entertainment and information. From the American viewpoint, these negotiations were not completed successfully. From the Canadian viewpoint, Canada has

---

[16] Acheson and Maule, International Agreements, 3.

[17] Ivan Bernier, "Cultural Goods and Services in International Law." (Publication forthcoming in *The Culture/Trade Quandary: Canada's Policy Options; Ottawa: Center for Trade Policy and Law.)*

maintained the right to use domestic regulation to implement cultural policy because it did not take National Treatment and Market Access obligations. It also listed an MFN exemption for its co-productions. In fact, the audiovisual sector was excluded from the agreement altogether. This sector will likely be the subject of negotiation during the next round of services negotiations.

The United States concerns in the cultural area are about all countries, not just Canada. During the Uruguay Round, European Union (EU) policy required 50 per cent European content on domestic television. It was France, in particular, that was inflexible about removing these perceived trade barriers. Hollywood argued that the *Europe Without Frontiers* policy was contrary to the spirit of liberalization in international trade in services and should be eliminated or phased out. Negotiations collapsed when the EU made no National Treatment or Market Access commitments for the audiovisual sector. The EU also listed eight MFN exemptions for audiovisual trade for indefinite time periods in its schedule of commitments.[18]

The GATS has a built-in commitment to continue to liberalize through further negotiations. There was also a commitment to launch new negotiations by January 1, 2000. These services negotiations do not with certainty include the audiovisual sector, but given the American interest in liberalizing trade in this major American export, it seems unlikely that the audiovisual sector will continue to remain off the agenda. The Motion Picture Association of America (MPAA) wants it on the agenda and will push the United States government to press, on their behalf, for further liberalization. Canada will need to assess its intent, both economic and cultural, in such a negotiation.

Beyond this political reality and institutional framework, technology has changed the global market. It has created new industrial opportunities, but along with these exciting industrial developments has come regulatory questions. For example, Direct Broadcast Satellites (DBS) and digital broadcasting have increased the demand for product, and this increase may result in different domestic agendas among the industrial interests that have long pushed for protection. Not only does technology change domestic interests, but also it makes regulation more difficult. The GATS Annex on Basic Telecommunications covers international and domestic telephone operations, fax and data transmission, private leased circuits services, satellite communications, mobile telephones and paging. While it does not include broadcasting services, the ability of governments to monitor and/or regulate services provided over such networks is questionable. Technology results in the need to rethink definitions of broadcasting and telecommunications.[19]

---

[18] Bedore, 25.

[19] Bedore, 26.

ii) The FTA , the NAFTA and the Exemption

The NAFTA includes a cultural exemption which includes a definition of cultural industries. This approach was established under the FTA where Canadian negotiators were able to exempt cultural industries from most substantive disciplines. Under Article 2005(1), however, the US may take measures of equivalent commercial effect in response to actions that would have been inconsistent with the Agreement but for the cultural exemption. Annex 2106 of the NAFTA provides that any measure adopted or maintained with respect to cultural industries would be governed exclusively in accordance with the provisions of the FTA. This Annex applies to Canada and to any other country. With respect to film, Canada and Mexico maintained their co-production treaties and their ability not to extend the rights granted under these treaties to the United States.[20] In order to understand the NAFTA obligations with regard to culture, one has to go back to the FTA to determine the quality of the culture exemption, and whether or not there is latitude for the United States to retaliate.

The exemption has not been exercised to date by Canada or the United States. This fact is used by some to demonstrate how well the exemption has protected Canadian policy and by others to reveal how little the exemption protects Canadian domestic policy choices. The problem is that it if the exemption is exercised it is unclear what exactly "equivalent commercial effect" will mean. Another concern for Canada is that although Canada may have provided itself protection in the NAFTA, the United States can and has used the WTO or United States domestic trade remedy law to pursue its objectives. It is not clear how much an agreement for "no rules" will continue to help Canada. The problem for Canada is that the alternative to an exemption, new rules, could give Canada less flexibility. The question of whether to pursue rules or exemptions is a central one for the trade and culture debate in Canada.

Both rules and exemptions have advantages and disadvantages. Although the NAFTA exemption has been effective in that it is yet to be invoked, alternatives to it mean that Canada's flexibility is still limited. Rules are perceived to reduce flexibility; however, this fact is yet to be proven. A clear benefit of rules is that they increase certainty. The alternative to rules, exemptions, allow for more policy flexibility, but results in uncertainty. Acheson and Maule are correct to say that attempts to insulate the cultural industries from international trade and investment rules have not fully succeeded.[21] It therefore seems that Canada may move to a rules-based approach. These rules could be negotiated in existing forums such as the GATS or in a separate agreement on culture. Given that negotiations in services will occur in 2000 within thmultilateral WTO context, Canada may desire to focus its negotiating energy on the WTO.

---

[20] Keith Acheson and Christopher Maule, "Copyright and Related Rights: The International Dimension," *Cultural Developments in an Open Economy- Canadian Journal of Communication*, 19(3/4 Special Issue), 1994.

[21] Keith Acheson and Christopher Maule,*The Culture of Protection and the Protection of a Culture- A Canadian Perspective in 1998*, Ottawa: Carleton University, Department of Economics, 21.

iii) The MAI

The members of the Organization for Economic Cooperation and Development (OECD) agreed to begin negotiations on a Multilateral Agreement on Investment (MAI) in 1995. The agreement is supposed to provide a comprehensive multilateral framework of principles to govern the treatment of foreign investment. The agreement is intended to provide National Treatment to protect investments and investors. The draft agreement, which has not been finalized, recognizes that countries have different priorities and interests, and thus it allows each country to lodge exceptions to the basic rules established in the MAI.

There has been concern expressed about culture and/or cultural industries, and some countries, including Canada, filed an exception for their cultural industries during the negotiations, which are not yet complete. Canada and others have expressed fears about culture and believe that a cultural exemption is necessary to preserve cultural and linguistic diversity in their respective countries. Canada has supported a French proposal for a cultural exemption. The basic argument is that countries have the legitimate right to introduce policies that promote or protect cultural identity and linguistic diversity.

The problem with this, Canada has argued, is that the use of these measures in the cultural sector raises problems with respect to national treatment and MFN, and thus a cultural exemption in the MAI is necessary. Given that the United States and others oppose broad cultural exemptions, the question remains what exactly can be achieved through this measure. William Merkin, a former United States trade negotiator, states that "the United States is not in position either politically or from a commercial perspective to grant any nation carte blanche to restrict our access in . . . the entertainment sector, which is an important export earner for the U.S." He predicts that both sides will agree on a NAFTA-like measure, which allows countries to maintain current measures.[22]

For Canada, this exemption would be relevant for the film industry. In Canada, foreign-content movies represent 90 per cent of film distribution revenues. The argument has been made that without investment measures Canada would find it even more difficult to preserve space for Canadian product. Those who espouse this view assume that without the foreign investment policy for film distribution, Canada would lose even more control of its film distribution sector. Even if Canada is successful in negotiating an exemption, the question will be to what extent investment measures can remain effective given the changing nature of the United States industry, of distribution as a result of technological advancement, and of international trade.

The MAI negotiations have been suspended at least until the autumn of 1998 as a result of missing the deadline of April 1998. This deadline was not met because a variety of issues, including the cultural one, remained outstanding. Negotiations could resume again at the OECD,

---

[22] Rosanna Tamburri, "Canada Considers New Stand Against American Culture" *The Wall Street Journal*, February 4, 1998.

as ministers suggested, or take place at the WTO as part of a future set of comprehensive negotiations.

iv) The Challenges Imposed by Global Trade and Investment Agreements

The issue of trade and culture has presented challenges for Canadian policy-makers. The issue became of particular concern when Canada's 80 per cent excise tax (Bill C-103) on revenue from Canadian advertisers received by foreign companies publishing magazines in Canada was opposed by the United States. On March 11, 1996, the Clinton Administration announced that the United States would use the dispute settlement procedure of the WTO to challenge what the United States called discriminatory practices by the Canada that unfairly protect Canada's domestic magazine industry. The United States government charged that Canada was unfairly keeping American magazines, specifically *Sports Illustrated* of Time Warner Inc., out of the Canadian market.

Initially, the WTO ruled against three out of four of the measures that Canada used to protect its magazine industry. On appeal, Canada lost on all four measures. These measures were the 80 per cent excise tax, a rule against the importation of split-run magazines that direct more than five per cent of the advertisements to Canadian audiences, differentiated postal rates, and the postal subsidy. Section 19 of the Income Tax Act, which disallows the deductibility of advertising expenses in foreign-owned magazines aimed at the Canadian market, was not challenged and thus remains in place. The WTO ruled against Canada because it found that magazines were a good comprised of two kinds of content – editorial and advertising. Because magazines were found to be a good, not a service, Canada was required to treat like products the same.

The WTO panel was careful to state that the ruling did not mean that countries could not have cultural policy; however, this decision leaves Canada scrambling for a new set of cultural policies for the magazine industry. This *Sports Illustrated* decision is important to the film industry, not only in that it leaves Canada concerned about how well its policies will comply with its international trade and investment obligations, but also in that American resolve to continue to press for changes the United States industry has long desired may increase.

These general concerns are important when thinking about a film policy, but this WTO decision also had a more specific consequence. It raised the issue of what is a good and what is a service. In the case of spilt-run magazines, the advertisements were found to be goods although Canada argued that they were services. This issue also came up when the United States challenged the European Union at the WTO on its regime for the importation, sale and distribution of bananas. While the GATS and GATT 1994 were intended to address different subject matter, they seem to both be applicable with respect to certain measures, which involve a

service relating to a good or a service supplied in conjunction with a particular good.[23]

Whether film distribution is treated as a good or as a service will be a central question for Canada and the United States. If film is treated as a good, it will be dealt with in GATT 1994[24], while if it is treated as a service it will be dealt with in GATS. Ivan Bernier states that:

> Thus, although cinema is specifically mentioned in Article III and Article IV of GATT 1994 and duty concessions have been made in relation to films, the fact is that cinema has been considered as a service in the . . . [GATS], in the OECD Code on Invisible Current Transactions, and in the United Nations Classification of Industries. This possibility of conflict in the application of GATT and GATS raises a fundamental problem . . .[25]

The conflict of applications means that the exercise of a right under the GATS could be denied under GATT 1994. Bernier asks, for example, could "India's limitation on film distribution in its specific commitments under GATS, although in full conformity with the agreement and accepted by all parties to it, be challenged successfully under GATT?"[26]

Another WTO dispute that relates to the Canadian film industry ended recently because of ownership, not because of a WTO ruling or settlement. Canada refused to allow Polygram Filmed Entertainment Co. to distribute non-proprietary films in Canada. At the time, Polygram was a subsidiary of the Dutch conglomerate Phillips Electronics NV. Polygram was purchased by Seagrams in May 1998. The purchase of Polygram by a Canadian company changed the nature of the dispute about film distribution rights. Although it seems unlikely that this case will result in a WTO panel, it reveals some of the problems that can arise when domestic policy impacts on the business interests of corporations in other states. The European Union took Canada to the WTO over Canadian distribution, which resulted in a period of formal consultation, the first stage of a WTO dispute. The EU complaint was that the European film industry had been prohibited from access to the Canadian market for the distribution of non-proprietary films, while the United States film industry is not prohibited from such access.

Canada believed that in this case the government had fulfilled both its transparency and MFN obligations under the GATS. The transparency requirement mandates Canada to publish the policy and the MFN requirement obliges the application of the policy on an MFN basis, i.e. without regard to country of origin. All companies established, or who have applied to become

---

23 This particular issue is being watched by the MPAA. The MPAA is interested in this issue because the organization would like to ensure that film distribution is addressed under the forum with the most rules for liberalization.

24 GATT 1994 is part of the World Trade Organization.

25 Bernier, 3.

26 Ibid, 4.

established prior to February 13, 1987, are not subject to the policy regardless of their nationality. All other companies established after that date are allowed to distribute proprietary films only, again regardless of nationality. Furthermore, Canada did not commit to any market access or national treatment obligations under the GATS as discussed above.

Even though this trade irritation likely has ended with the purchase of Polygram by a Canadian enterprise,[27] what is of concern for Canada is that its cultural policies continue to be challenged. In this case, the challenge did not come from the United States, but from the EU, which typically has been more of an ally on cultural policy. The Polygram case demonstrates how difficult it can be to implement certain types of cultural policy that do not irritate trading partners. It also demonstrates that allies can be foes as national interests change. In the case of Polygram, the interests of the EU were to have access to the Canadian market. These industrial interests were not mitigated by the fact the Canada and the EU often have similar approaches to cultural issues.

This case also demonstrates that global cultural or entertainment industries are undergoing rapid change. Canada is now becoming an increasingly important player, or, at least, some Canadian companies are becoming world players. As this change occurs on a global basis, some of Canada's policies may no longer be relevant. In the case of Polygram, it remains to be seen whether Canadian ownership will change the content of the product that is distributed. The challenge of achieving high levels of Canadian content in feature films will likely remain as difficult or almost as difficult. An essential question is whether firms owned by Canadians share the Canadian government view on the uniqueness of the cultural industries. Canadian owned programs may share this vision, or may look at the cultural industries in more business and less social terms.

C: <u>The Other Challenges of Globalization</u>

i) The Technological Challenge

This paper has suggested at the beginning that, as a result of the international rules, obligations, and uncertainties, the film industries both in Canada and the United States are undergoing change. First, technology has changed the industry. Film exhibition no longer represents the main source of revenue for the industry. The trend toward earning revenues in alternative forms of distribution seems as though it is certain to continue with the advent of digital television. There is now more demand for good products on a global basis. This demand means that there are opportunities and challenges for both countries. The United States is advantaged in that the Hollywood studios have stores of ready-made products available for distribution. Canada also has ready-made products available, although not in the same amounts.

[27] The EU under its anti-trust rules must still approve the sale of Polygram. It must also be noted the new trade issues could emerge if Seagrams attempts to sell Polygram. Such a sale could violate the Investment Canada Act, but if allowed could bring about new trade conflicts. The Investment Canada Act will be discussed in more detail in part III, section iii.

The greater problem for Canada is the lack of developing interest in this products. Perhaps a greater investment in the marketing of Canadian products could begin to develop this interest. The United States' companies also have the production budgets and distribution networks to take advantage of changes in the industry.

This does not mean that opportunities for Canada and other countries challenged by the power of Hollywood will disappear. The demand for massive amounts of products may aid the Canadian industry. The idea of preserving shelf space within Canada for Canadian products may become less relevant as more opportunities for distribution create more opportunities for production. This does not mean that Canada's concern with access to distribution within its own market is irrelevant, but it does mean that Canada should think about whether technology has changed the question from one about distribution to one more about distribution and production. Clearly, there exists more opportunities to sell product both within Canada and abroad. Furthermore, new technologies may be more difficult to regulate. Canadian policy may become more and more impotent if it relies on measures to control content in an environment that is increasingly difficult to regulate.

ii) The Commercial Challenge

This paper also has suggested that the Canadian and American industries evolve in different economic realities. The vertical integration in the United States is astounding and does present major challenges to those smaller companies both United States and foreign-based trying to build a competitive strategy. Despite anti-trust action against United States entertainment companies, there seems to be few in the United States that are concerned enough about competition in this increasingly vertically integrated industry to push for an investigation under United States anti-trust law. It seems therefore that Canada and others will have to work within the realities of this evolving new global entertainment industry.

A commercial solution is difficult. The Canadian industry is smaller, and it will continue to produce fewer films with a much smaller budget. Canadian policy cannot change market forces, but can address the challenges imposed by them. In Canada, the industry has been characterized by a certain amount of government measures intended to promote the Canadian film industry. In film, these measures have not been particularly successful - few Canadian products are distributed to major screens in Canada. Film policy has provided tax incentives and subsidies to producers, as well as protection to distributors, but Canadian exhibition houses still show little Canadian product. Canada cannot expect to create a Hollywood North, no amount of government support will achieve this goal. Government policy has been more successful in regulated industries such as radio and television; however, it can and has helped the Canadian production industry, which has grown significantly in recent years.

The question is: how can this support be channelled to help Canadian goals? To answer this question, it is necessary to answer whether these goals are cultural, industrial or both. Policy should more carefully address the complex interplay between culture and industry. This

interplay must be understood in order to create appropriate domestic measures. Measures that seem more about protecting industrial interests and less about preserving a space for Canadian culture to prosper are more likely to be challenged. For example, with the Polygram case it was the distribution policy that was challenged. Many would argue that the Canadian policy has worked to protect industrial interests, but has done less to ensure Canadian production and exhibition. The film review currently underway by the Department of Canadian Heritage should examine what are the real challenges to the Canadian film policy. In other words, is distribution the culprit or is there something more complex at play?

The goal for Canada should not be to compete on the terms of the Hollywood majors, but on the terms of the best independents from around the globe. The 1997 film, *The Sweet Hereafter*, for example, did not generate the considerable revenues that *Titanic* achieved on a global basis; however, its productions costs were $4 million as opposed to $260 million for the latter film. This film constitutes a Canadian achievement. Its success needs to be compared to other similar productions, not ones with budgets 80 times as large. Furthermore, Canada cannot find a national solution that does not view the entertainment industry as a global industry. Canadian production needs to see the world as their market in order to access the distribution required for higher production budgets. This raises questions about Canada's cultural goals; it seems that a product can have national character and international appeal. *The Sweet Hereafter* appears to demonstrate this. It also raises questions about what kind of support will help the Canadian industry. The question about the relationship between public support and commercial viability needs further study. Furthermore, if Canadians want access to the world, they must consider to what extent they can achieve this when they are perceived to be protecting their own market.

iii) Meeting the Global Challenges

The global entertainment industry has undergone significant change in recent years. These changes challenge policy-makers around the globe. What is clear is that new international trade and investment obligations will continue to challenge the ability of governments to protect domestic industries from competition. Technology will continue to re-invent the entertainment industry. The commercial challenges presented by Hollywood's global strength are significant for Canada and most other countries; however, the economic reality of the global entertainment market cannot easily be altered. Canadian policy-makers must understand these constraints and develop both realistic objectives and means for achieving these objectives.

In order to understand the appropriate direction for Canadian film policy, it is necessary to examine the industries in both Canada and the United States. The next section will look at support measures and provide a detailed analysis of production, distribution and exhibition in both countries. This analysis will demonstrate how two different realities result in two different views. It is these differences that, at times, result in conflict. This conflict results from real philosophical differences. It reflects Canada's greater role for government. It reflects a different attitude about the concept of cultural industries. Conflict occurs because the industrial goals of

Canadian policy often result in certain restrictions which the United States cannot accept as having important cultural consequences. It is these different views that are taken to international negotiations on trade and investment.

III. TWO DISTINCT INDUSTRIES FACING DIFFERENT GLOBAL REALITIES

A: The Canadian Industry

The Canadian feature film industry is characterized by a considerable amount of government involvement. There exists policy, legislative activities and a variety of financial programs to support the film and video industry. Both the Department of Canadian Heritage and Industry Canada make policy and address legislative issues. The Department of Canadian Heritage, Telefilm Canada (also called the Canadian Film Development Corporation), the National Film Board of Canada, the Canada Council, and the Canadian Television and Cable Production Fund constitute the financial programs that support the industry.[28] There also is support for the industry at the provincial level.[29]

The Canadian film and video industry can be divided into three parts: production, distribution and exhibition. The Canadian film and video production industry is characterized by a large number of relatively small companies. These include: Cinar, Malofim Communications, Nelvana and Paragon.

i) Canadian Support Measures

The Canadian government has tried three main approaches to supporting private industry: tax incentives, direct investment, and international co-production treaties. Over the last decade, this emphasis has shifted from tax incentives to direct investment and support for international co-productions.

Traditionally, tax incentives constituted an important means of support for the Canadian film industry. The Capital Cost Allowance (CCA) was in effect from 1974 to 1987. The CCA allowed for a special capital cost allowance rate of 100 per cent, with a right to apply the allowance as a deduction against taxable income generated from other sources. The CCA was reduced to 30 per cent in 1988 and eliminated in 1995.[30] The problem with the CCA, according to the recent DCH report, is that the fund, although partially successful in attracting private financing to film production, did not address issues related to distribution or exhibition.

In 1995, the federal government introduced a new film and video tax credit. The Canadian Audio-Visual Certification Office (CAVCO) administers the Canadian Video Production Tax Credit. The Credit is available only to Canadian controlled productions. This credit amounts to 25 per cent of eligible labour expenditures for a Canadian film or video

---

[28] Statistics Canada, *Canada's Culture, Heritage and Identity: A Statistical Perspective 1997 Edition*, catalogue 87-211, 55.

[29] These provincial measures are beyond the scope of this paper.

[30] Colin Hoskins and Stuart McFayden, "Telefilm Canada Investment in Feature Films: Empirical Foundations for Public Policy,*Canadian Public Policy*, XXII:2; 1996, 152.

production. Total layout expenditures cannot exceed 48 per cent of the cost of an eligible production. Former Heritage Minister Michel Dupuy stated that "the primary objective of this new credit remains the encouragement of Canadian programming and the development of an active production sector."[31] In 1997, the Film and Video Production Services Tax Credit was introduced to "encourage Canadian and foreign film-producers to employ Canadians for production services performed in Canada."[32]

Direct investment and subsidies also have been an important element of Canada's public policy. Most of the public support for the industry has been received through the National Film Board (NFB), which was created in 1939. Direct financial support was provided through the Government of Canada when it created the Canadian Film Development Corporation (CFDC) in 1967 and allocated $10 million to this new entity. Over the years, government support to the CFDC has increased. In 1984, the CFDC was renamed Telefilm Canada. This government-sponsored agent administers a range of funds and programs to assist the development of the Canadian film and video industry. Its total annual budget in 1997/1998 is approximately $175 million. The Canadian view is that "[through Telefilm's] various Funds and Programs, the Corporation fosters the development of an independent Canadian industry that can provide programs and feature films comparable to the best independent productions from around the world."[33]

Telefilm oversees the Feature Film Fund, which was created in 1986 with the purpose of supporting Canadian film-makers, and the Feature Film Distribution Fund, which was created in 1988 with the purpose of supporting experienced distribution companies in their marketing, rights acquisition, and corporate development activities. The $ 200 million joint industry-government Television and Cable Production Fund was announced by the Department of Canadian Heritage in 1996. Telefilm administers the Equity Investment component of the Fund.[34] This fund is for the production of feature films that eventually find their way to television.

All companies funded by Telefilm Canada must be Canadian owned and controlled. Ownership is determined according to the criteria established by Investment Canada. Telefilm also requires that more than 50 per cent of the company's shares, on a diluted basis be owned by Canadians and that the company's operations be under their effective control. Generally, eligible Canadian companies must operate in Canada or have a head office in Canada. Telefilm is clear that its goals are both cultural and economic.[35] The double-edged objective of Telefilm highlights

---

[31] Statement by Canadian Heritage Minister Michel Dupuy on New Film and Video Tax Credit Measures, December 12, 1995.

[32] Department of Canadian Heritage, *A Review of Canadian Feature Film Policy-Discussion Paper*, February 1998.

[33] Telefilm, Canada, January 5, 1998, 2.

[34] Department of Canadian Heritage, *Discussion Paper*, 5-6.

[35] Hoskins and McFayden, *152*.

the fact that cultural policy has long had both cultural and industrial origins.

The following list, from the DCH Discussion Paper, summarizes current federal measures in support of the Canadian Feature Film Industry:

Telefilm Canada
It provides about $40 million annually for the development, production, distribution and marketing of Canadian feature films.

Canadian Television and Cable Production Fund
It provides about $15 million for the support of productions of feature films that will be on television. This is from a total of $200 million that is dedicated to the annual budget.

The Canadian Film and Video Production Tax Credit
It provides Canadian producers with about S60 million a year through a refundable tax credit worth up to 25% of the costs of eligible labour costs.

Film and Video Production Services Tax Credit
This credit is worth up to 11% of the cost of qualifying Canadian labour expenditures for production services performed in Canada.

The Foreign Investment Policy for Film Distribution
This policy helps ensure that foreign investment in Canadian film distribution sector results in a net benefit for Canada.

National Training
Support for this provides $1.3 million annually to film and television training initiatives.

These Canadian support measures constitute central components of Canadian cultural policy. Subsidies and tax incentives do not always ensure that the support is directed to products with high Canadian content. The importance of a content-oriented focus is revealed by the ruling against Canada at the WTO with respect to the Sports Illustrated case, which was discussed above. The effect of this ruling is that Canada can no longer assume that measures will not be challenged and that they will survive international scrutiny if challenged. Subsidies and tax incentives, which have a role in Canadian cultural goals, need to have a cultural or content focus that does not conflict with Canada's international obligations in order to survive increasing international scrutiny.

Co-productions also are an important part of Telefilm Canada's activities and also a main pillar of Canada's film policy. Telefilm Canada states that:

Co-production arrangements are an increasingly popular means of sharing the high cost of producing high-quality, culturally significant productions. An official co-production agreement enables Canadian and foreign producers to pool their creative, artistic, technical, and financial resources in order to co-produce films and television programs. The objective of these arrangements is to give producers access to new sources of funding and facilitate access to foreign markets.[36]

The Government of Canada, through the Department of Communications (now DCH), negotiated approximately 40 international co-production treaties. The assumption is that co-productions create a means to effectively assemble budgets to compete with Hollywood.[37] Co-productions then should help mitigate the small country disadvantage and therefore help non-American productions succeed globally. The co-productions are protected under the General Agreement on Trade in Services (GATS) because Canada took a Most Favoured Nation (MFN) exemption for its co-production agreements. When there are new GATS negotiations, if the audiovisual sector is covered these exemptions could be revisited.

ii) Production

The film and video industry includes theatrical features, music videos, television productions and commercials, corporate government and educational films and videos, as well as other types of production. In 1994-1995 almost 14,000 film and video productions were made in Canada; however, less than one per cent of these films, or 38 in total, were for the theatrical market. Production for the television market accounts for 70 per cent of all productions and 40 per cent of all production revenue.[38] There are a number of support measures for these films that are listed in section v.

While 38 feature films constitute a small number, it is not as small as it may appear when compared to the number of films produced in the United States. In 1994, in the United States, 400-450 films are made each year. Only about 160 of these ever become "major" films. In fact, two out of every three never recover production costs, even after sales to cable television and home video.[39] When population is considered, Canada's numbers no longer seem so low. What may seem low is rather the number of Canadian films that become "major" films. Therefore the question is do smaller budgets prevent Canadian films from becoming majors or is there another reason, or combination of reasons, such as lack of an ability to access distribution, poor quality, or lack of a universal message in Canadian film that explains why Canadian films find success both within and outside the Canadian market difficult? The answer to this question is essential

---

[36] Telefilm Canada, January 5, 1998, 2.

[37] Hoskins and McFayden, 152.

[38] Statistics Canada, 55-56.

[39] Bedore, 18.

for the development of Canadian film policy.

The Department of Canadian Heritage conducted a film review early in 1998. In the report, the Department states that eighty-seven feature films were produced in 1995. Seventy per cent or 61 of these films were released in theatres. The report states that Canadian average production budgets have decreased since the late 1980s while they have increased in other countries. It also notes that Canadian films, when compared with films in other countries, are not achieving success in their own market. The report contends that there appears to be a correlation between the production budget and a film's ultimate success.

This correlation is not always clear. A representative from Telefilm Canada stated that on a ratio basis of production cost to total sales, *The Sweet Hereafter* did quite well compared to *Titanic*.[40] Clearly, budgets do not mean everything. Lower budget films can have a high return on capital, while higher budget ones can also fail to recover their costs. However, higher budgets certainly can be an asset. They allow for more interesting cinematography, better known actors and more aggressive marketing. They do not ensure, however, a more interesting story.

Again, content is an important theme. Good content will sell. This content need not be homogenized to an aseptic international standard, but it must have salience internationally. Canadian stories will sometimes have this salience and at other times these cultural products will only garner the interest of a domestic audience. This fact makes it even more clear that cultural and industrial policy should be separated where possible. Canada should support Canadian production to tell Canadian stories, but need not support the production industries to produce products tailored for export. Once again, it is these more industrial policies that will most likely be challenged by Canada's trading partners.

iii) Distribution

Film distribution is central to the Canadian film industry. The revenues from film distribution generate the funds for more Canadian production. In Canada, Hollywood has managed to maintain a large degree of control over film distribution revenues. As a result, most of the revenues generated from film distribution have flowed directly to the United States. While foreign film distributors traditionally have represented 15 per cent of all film distributors operating in Canada, they have controlled 85 per cent of the revenue from film.[41] Not only do foreign distributors earn a significant amount of Canadian film revenues, but also the revenues they earn in Canada constitute a significant amount of their own total revenues. Warner Brothers' *Batman Forever* opened on 2,842 screens in North America; 388 of those were in Canada. Canadian cinema goers accounted for $7 million or 14 per cent of this film's opening

---

[40] Arts and Culture Conference Speaker, Department of Foreign Affairs and International Trade, Ottawa, March 1998.

[41] Department of Canadian Heritage, *Discussion Paper*, 9.

week-end. The structure of North American distribution has hindered the ability of the Canadian industry to earn revenues to make larger budget Canadian productions.

In 1987, Investment Canada adapted its publishing policy to apply to film distribution. The National Film and Video Production Bill proposed separating Canadian from United States distribution rights for independently produced foreign films. In the end, the 1988 Canadian Film Distribution Policy required a Canadian-controlled joint venture for investment in Canadian businesses. Foreign controlled businesses are subject to government review. Any investment to establish new businesses must be linked directly to the importation and distribution of proprietary products (i.e. the importer must own world rights of the film/video or be a major investor in the product). Specifically, the guidelines in the *Investment Canada Act* are as follows:

a. foreign takeovers of Canadian-owned and controlled film distribution will not be allowed;

b. new foreign distributors will only be allowed to distribute proprietary films (proprietary films are considered to be any film where the distributor owns world rights or is a major investor) and;

c. takeovers of foreign distribution businesses operating in Canada will be reviewed to determine their net benefit to Canada. Along with the new policy on foreign investment, the 1988 initiative led to the creation of the Feature Film Distribution Fund administered by Telefilm Canada.[42]

The reason for this change was that the main opportunity for Canadian film companies has been to acquire the Canadian distribution rights for independently produced, that is, non-Hollywood films. The 1988 film distribution policy was designed to give Canadian film companies access to the Canadian market by barring the entry of foreign companies to distribute independently-produced films that they do not own.[43]

This approach was vehemently opposed in the United States. *Toronto Star* reporter, David Crane, stated that the Hollywood studios enlisted the support of former U.S. President Ronald Reagan to pressure then Prime Minister Brian Mulroney into withdrawing this proposed film distribution legislation. Crane reported that Reagan told Mulroney that the U.S. Congress would not pass Canada-U.S. free trade legislation if Canada took on the Hollywood studios.[44] Again, this opposition from the United States not only demonstrates a different philosophical approach, but also how this difference can challenge and at times constrain Canadian policy.

[42] Ibid.

[43] David Crane, "Film-rights policy row divides federal cabinet," *The Toronto Star*, September 10. 1996.

[44] Ibid.

The 1988 policy has been applied on a non-discriminatory basis since its implementation ten years ago. The policy allows new foreign distributors to establish in Canada, but only for the distribution of films for which the distributor operating in Canada has world wide rights or is a major investor (proprietary rights). All foreign distributors operating in Canada prior to the implementation remained unaffected, regardless of their nationality, and were allowed to continue their existing business. All investors seeking to establish new film distribution businesses in Canada are subject to the 1988 Policy, regardless of nationality.

It is argued in the *Review of Canadian Feature Film Policy* (February 1998), by the Department of Canadian Heritage (DCH), that "traditionally, [foreign distributors'] interest has not been in the distribution of Canadian films. The government has argued that this contention is supported by the fact that only 0.4 per cent of total revenue is generated from Canadian film. Therefore, it is argued that Canada needs a policy to promote distribution of Canadian films. The DCH report contends that as a result of the 1988 policy, Canadian distributors increased their share of the total theatrical revenues by 3.6 per cent, from 13.4 per cent to 17 per cent. The proportion of revenue generated by Canadian distributors from Canadian films has increased from 29 per cent in 1986-1987 to 49 per cent in 1993-1994.[45] These statistics reveal that since the new distribution policy was put into place, the Canadian distribution sector has had some success in distributing more Canadian product. However, there has been less success in raising Canada's market share in its own market. Box office receipts of Canadian films in Canada have remained unchanged in Canada since 1984 at about 4 per cent. Given that this seems to be the ultimate objective of the policy, its success is questionable. Certainly it did solve some industrial problems that affected the distribution sector, but the policy did not provide Canadians with significantly greater access to their own market.

Some argue that Canada's appeasement to the United States, by allowing the United States studios already in Canada to remain in Canada under the pre-1988 conditions, has created visible vulnerabilities for the Canadian industry. Vancouver and Toronto now constitute major production centers, but much of this production, specifically in Vancouver, is American. Dan Johnson, former executive director of the Canadian Association of Film Distributors and Exporters (CAFDE) argues that it is indigenous distribution that stimulates indigenous production.[46] Alliance and Malofilm are Canadian successes, but their core distribution business is reliant on American companies.

The domination of the distribution sector by subsidiaries of foreign entertainment multinationals remains a central concern of Canadian film policy. It is this issue that brought Canada into conflict with the European Union over Polygram. The question remains, why has distribution been so complicated in Canada? Acheson and Maule do not believe that there is an American bias against distributing Canadian programs. Basically, they contend that

---

[45] DCH Film Policy Review

[46] Interview 1997.

commercially driven firms will distribute any material in any market that is likely to make money. "American and other distributors do not knowingly ignore profitable opportunities in Canada or abroad. If they did it, it would be a bonus for Canadian distributors who could seize the opportunity."[47]

This question about distribution has become of central importance to Canadian film policy. Canadian distributors now commit more money to the distribution and marketing of Canadian films than they generate in revenues from these films. It seems that marketing is becoming an increasingly important component of film distribution; however, Canadian distributors do not have the money to commit to it.[48] Also there remains the concern that Canadian distributors do not have sufficient market power to influence release dates and theatre locations. The performance of Canadian distributors must therefore be improved. The means by which this should be done is unclear. The Canadian 1988 film distribution policy, which could be challenged by our trading partners again, attempted to help this sector's performance. Its initial intent, although its application was more limited, was to address the fact that Canadian rights to foreign independent films are often bundled with U.S. rights into North American rights packages. Canadian distributors both before and after the 1988 policy could not generally afford the cost of these North American rights. Given the limited success of this distribution policy, Canada must re-think its approach in order to meet our domestic and international interests. Again policy, should service our cultural interest, but should not do so by industrial means, which will likely be challenged by Canada's trading partners.

iv) Exhibition

The exhibition sector includes both movie theatres and video stores. Both are market driven. The DCH report notes that "Canadians continue to flock to see feature films: in 1995, more than 80 million theatre tickets were sold in Canada, representing a total box office revenue of about $400 million...." The issue for Canada is how many of these 80 million tickets where purchased to see Canadian productions?[49] The problem is that Canadian films only constitute between 1 and 3 per cent of box office revenue.[50] The performance of Canadian titles in video stores is not much better.

In a recent paper, Daniel Schwanen contends that in "...discussing the problems of the Canadian film industry, the single indicator that recurs most often is the tiny proportion of screen time in Canada actually devoted to Canadian films. 96% of Canadian theatrical screen time is

---

[47] Keith Acheson and Christopher Maule, *Canada's Cultural Policies-You can't have it both ways*, Ottawa: Working Papers Series-Carleton Industrial Organization Unit, Department of Economics, Carleton University, 1996, 9.

[48] DCH Film Policy Review

[49] Ibid.

[50] Department of Canadian Heritage, *Discussion Paper*, 9.

dedicated to foreign films.[51] Most of this is monopolized by the major American studios, each of which has a distribution arm in Canada. English language Canadian films experience the most difficulty.

The Canadian theatrical market is dominated by two chains: Cineplex Odeon and Famous Players. A group of Canadian investors established Famous Players in 1920. In 1930, control over this company was lost to United States-based Paramount Pictures. In 1994, the ownership of Paramount was transferred to the United States entertainment company, Viacom.[52]

A group of Canadian investors also created the Odeon theatre chain in 1941. It was sold to Britain's largest vertically integrated company, the Rank Organization in 1945-1946. Garth Drabinsky and Nat Taylor, who started Cineplex in 1977, purchased Odeon in 1984. A 50 per cent equity interest in Cineplex Odeon was purchased by MCA (parent of Universal Pictures) in 1987. Cineplex has grown to be one of the largest exhibitors in North America. In 1993, their screens accounted for 8 per cent of total North American box office revenues. In 1995, Canadian owned Seagram Co.'s purchase of 80 per cent of Universal Studios Inc. gave the Bronfman family control over 66.2 per cent of Cineplex stock - Universal's 41.6 per cent stake in Cineplex plus the families existing 24.6 per cent.[53] However, the financial problems that have plagued Cineplex Odeon resulted in its sale to Sony Corporation, which according to the sales agreement will own 51 per cent of the company by 2001. By mid 1998, North America's largest exhibition chain by revenue (approaching US $1 billion) will be created with the merger of Cineplex Odeon and Sony's Loew's Theatres. The approval of this deal still requires regulatory approval in both the United States and Canada.

The dominance of Cineplex Odeon and Famous Players is an important characteristic of the Canadian film industry. These two players account for about two-thirds of annual theatre revenues. Both maintain ongoing supplier relationships with the Hollywood majors. Magder states:

> Famous Players has first-run rights in Canada to all MGM-United Artist, Paramount, and Warner Bros. Films, while Cineplex Odeon (had) exclusive first-run rights to the films of Columbia Pictures and Universal Studios. The two chains share the distribution rights for films from other studios. This arrangement helps to reduce business uncertainty for the major chains, and all but guarantees the best available screen time for the feature films distributed by the American majors. It also has the effect of marginalizing feature films distributed by the non-majors (which includes virtually all Canadian films), both in terms of access to most first-run, high profile theatres and in terms of the most attractive play

---

[51] Daniel Schwanen, *A Matter of Choice: Toward a More Creative Canadian Policy on Culture*, Toronto, C.D. Howe Institute, April 1997, 28.

[52] Ted Magder "Film and Video and Production," in *The Cultural Industries in Canada-Problems, Policies and Prospects*, ed. Michael Dorland (Toronto: James Lorimer & Company Ltd., 1996), 149.

[53] Barbara Schector, "So long, Cineplex," in *The Financial Post*, November 22, 1997.

dates, such as the Christmas season.[54]

According to Pendakur, the idea of mandatory screen quotas for Canadian films was considered in the 1970s. The idea was for "a flexible exhibition quota to be tied to film production capacity and the earning power of the exhibitor." In 1973, "the Secretary of State reached an informal agreement with Famous Players and Odeon to make two weeks of screen time available for English Canadian films" in Montreal, Toronto and Vancouver.[55] These quotas never became part of legislation and therefore never resulted in an effective permanent method of enduring Canadian films access to distribution. These demand side measures have not figured prominently in Canadian policy. Quotas assume that there is a pent up demand in Canada for Canadian films that is not being met. The success of quotas seems questionable. First, it is not clear that Canadians are demanding home-grown products that have already been produced and that is not distributed. Second, the GATT prohibits raising screen time quotas that were already in place. It is almost certain that new quotas would be challenged by Canada's trading partners.

v) Canadian Policy Direction in light of International Obligations

Canadian support measures constitute a direct aid to industry. These measures have industrial and cultural components. On the domestic level, industrial policy (and for that matter cultural policy) raises the questions of who such policies are intended to help and whether the support measures provide the desired result. The film policy review emphasizes the cultural reasons for support measures. It also states:

> In addition to its cultural significance, the Canadian film and video industry is an important economic force. It accounts for almost 30,000 Canadian jobs and contributes $2.8 billion to Canada's Gross Domestic Production.[56]

Does support for production or ownership restrictions help only those who receive support, or is there some greater benefit to Canadians? If industrial policy does not provide more general benefits it is misplaced. At the international level, questions about industrial policy are even more complex. It impacts on each country's trade and investment relations with other countries because industrial policy often constitutes veiled protectionism.[57]

Economist Steven Globerman notes that the commercial feature film business is highly competitive. He states:

---

[54] Magder, 149.

[55] Pendakur, 159.

[56] Film Policy Review

[57] Goldfarb, 99-100.

U.S. producers have a long-standing competitive advantage in the industry that is not likely to be eroded by marginal changes in the structure of Canada's domestic industry. Improving the competitiveness of Canada's feature film industry quite simply requires making more films that a greater number of people want to see. Commercially promising Canadian films will be distributed by the majors, since it is in the major's self-interest to do so. Commercially, unpromising Canadian films will require government subsidy regardless of who owns the distribution sector.[58]

While Globerman quickly dismisses the importance of access (perhaps too quickly), his emphasis on commercial production is important. With respect to incentives to foster Canadian production, the question for Canadian film policy is whether policy is mainly industrial and therefore focused on creating a viable industry capable of competing globally, or is policy cultural and therefore focused on communicating Canadian stories to Canadians. Globerman argues that direct public subsidies will promote the later, but likely will discourage the former because subsidized production need not be as responsive to market demands.

This does not mean that there is no place for public support of a film industry in Canada, but it does mean that all measures must be well thought out. Public funding will likely contribute to Canada's cultural objectives, but they may not meet Canada's industrial ones. First, government intervention reduces the need to respond to market forces both domestically and internationally. Second, some of these measures may not make much sense in a global entertainment market. Co-productions are becoming more and more the norm. In this environment, protectionist measures built around narrowly defined definitions of "Canadian-content" are unlikely to stimulate a durable competitive advantage for Canadian film producers.[59] Furthermore, these measures will be difficult for Canada to maintain as Canadian industry seeks access to other markets. The challenge is to define a realistic objective in Canadian film policy, and assess what kind of measures will achieve these ends. These measures that are intended to serve cultural goals need more clear definition and focus. These cultural goals need to be perceived as separate, or least more distinct, from industrial objectives. Clearly, industrial and cultural goals cannot always be separated from one another, but it is necessary to make some distinctions. Moreover, all Canadians, not just the Canadian cultural industries, need to have a voice in the formulation of Canadian policies.

B: <u>The United States Industry</u>

Since around 1960, foreign markets have generally accounted for about one-half of major United States' producers total sales in the film industry.[60] In 1994, global sales were

---

[58] Steve Globerman, "Foreign Ownership and the Canadian Film Industry," *Canadian Journal of Communications*, Vol. 16 (1991), 204.

[59] Globerman, 205.

[60] Steven Wildman and Steven S. Siwek, *International Trade in Films and Television Programs* (Cambridge MA: Balling Publishing Company, 1988), 1.

approximately $4.8 billion for all United States motion picture companies. Approximately $2.4 billion were earned in the United States and $2.4 billion in foreign markets.[61] The U.S. entertainment industry stands second to the aircraft industry in revenues earned from sales outside the United States. The visual media (film, video, television) generates about $18 billion in foreign revenues annually.[62]

i) United States Support Measures?

The issue of support measures is presented as a question because the United States does not offer tax incentives and subsidies to the American film industry in the manner that Canada does. This does not mean that United States industry is unsupported, but that its support is different.

On November 7, 1925 in the *Saturday Evening Post*, Edward G. Lowry writes, in an article entitled *Trade Follows Film*, that "the sun, it now appears, never sets on the British Empire and the American motion picture." Lowry quoted the Prince of Wales in this article as stating:

> If the United States abolished its diplomatic and consular services, kept its ships in the harbour and its tourists at home, and retired from the world's markets, its citizens, its problems, its towns and countrysides, its roads, motor cars, counting houses and saloons would still be familiar in the uttermost corners of the world...The film is to America what the flag was to Britain. By its means Uncle Sam may hope some day, if he be not checked in time, to Americanize the world.[63]

Lowry states, about American films, "...their world dominance is an incontestable fact. They are popular, they are affecting trade, they are [colouring] the minds and changing the desires of foreign peoples, they are the most vivid and potent projection - however distorted- of life in the United States that foreigners receive."[64] Thus, as early as the 1920s, the United States clearly recognized that films were important to trade and it broader foreign policy interests.

What is interesting about this 1925 article is its currency. Not only does it focus on trade,

---

[61] Bedore, 18.

[62] Kristen L. Kessler, "Protecting free trade in audiovisual entertainment: a proposal for counteracting the European Union's trade barriers against the U.S. entertainment industry's exports," *Law and Policy in International Business*, January 1995, col.26, no. 2, 563.

[63] Edward G. Lowry, "Trade Follows the Film," *Saturday Evening Post*, 198 (November 7, 1925), 12-13, 151, 158 in*Major Problems in American Foreign Relations Volume II:* Since 1914 (Fourth Edition,) eds. Thomas G Paterson and Dennis Merill (Lexington, MA: D.C. Heath and Company), 89.

[64] Ibid.

but it also espouses the same arguments with respect to the success of American film as are heard today. It is the universal appeal of the American movies that has resulted in their global success. The article states:

> There is no laughter in the European films. They lack gaiety, light-heartedness, sprightliness. They do not portray happiness. There is not in them anywhere any sense of irresponsible children at play. These lacking qualities are supplied in almost every American film. Our pictures show people having fun. They reflect freedom, prosperity, happiness, a higher standard of living in clothing, houses, interiors, motor cars-all the material appurtenances of good living.
>
> The European intelligentsia criticize the happy endings of our stories as bad-art. But . . . these happy pictures are beacon lights of hope. They seem to show the way to peace, prosperity and happiness. They make the spectators forget their cares and worries and anxieties. They bring relaxation and give entertainment. They are an escape from the daily routine of work. They open a fresh new world of play where there are no class restrictions or the inertia that comes of despair. That is why American pictures are popular abroad. I think, too, we know more of what can be done with the camera.[65]

The question of why the United States was and is the best at delivering a universally positive message is clear. However, it also is unclear whether a Canadian portrayal of happiness has the same opportunity to succeed both in Canada and the United States. Perhaps, it is that American competitiveness, the American first mover advantage, the American ability to draw on the world's talent and structural impediments that make entry difficult for non-American product.

The connection between film and politics was not only apparent in the 1920s, but has persisted. Explaining US policy, William Benton, Assistant Secretary of State in 1946, stated:

> The State Department plans to do everything within its power along political and diplomatic lines to help break down the artificial barriers to the expansion of private American news agencies, magazines, motion pictures, and other media of communications throughout the world ... Freedom of the press - and freedom of exchange of information generally - is an integral part of our foreign policy.[66]

---

[65] Ibid.

[66] Keith Acheson and Christopher Maule, "Shadows Behind the Scenes: Political Exchange and the Film Industry,"*Millenium Journal of International Studies*, vol. 20, no.2, 1991, 294.

The United States government, through the US Information Office, desired to keep European markets open for American films. This policy was not only about securing foreign markets for American products, but also was about selling American values and culture. In effect, it was a stand against the fear of creeping Communism.

The United States government through the State Department and the United States Trade Representative (USTR) continues to this day to pursue the interests of American industry by working to keep markets open for American goods and services. Both departments carefully follow Canadian activities in the cultural industries. The United States government publishes a country-by-country list of Trade Barriers to United States exports. Mickey Kantor, the former USTR, expressed concern about an increasing trend in "...Canada toward the implementation of policies which are intended to protect Canadian industry by discriminating against legitimate U.S. broadcasting, publishing and copyright interests in Canada."[67] Not only is the USTR vigilant about following Canadian developments, but the USTR also can affect changes in Canadian policy. For example, the USTR put strong pressure on Canada when the Canadian Radio, Television and Telecommunications Commission (CRTC) revoked the license of the United States channel, Country Music Television (CMT).[68] This particular case illustrates how American political pressure can be used to affect change in public policy in other countries.

The United States Information Agency (USIA) is charged with the promotion of American culture and values globally, partially through public support of artists abroad. While the National Endowment for that Arts (NEA) has experienced difficulties since its 40 per cent budget cut in fiscal year 1996, the origins of the organization demonstrate how the United States supports arts and entertainment, although this support is more specifically focused. The NEA publication *America in the Making* states "the arts are a strategic national resource dependent upon a strong private/public partnership. Our federal investment, though small, is crucial to America's continued economic, educational, international and social success."[69] United States public effort to keep markets open and to promote a more narrowly defined definition of the arts serves United States interests, in a similar manner as Canadian support measures have served Canadian interests. Both operate in a manner that assists each country's domestic industry. Both have an industrial and cultural component.

The MPAA (Motion Picture Association of America), founded in 1922, also worked to achieve more open markets for American films. In 1946, the MPAA organized the Motion Picture Export Association (MPEA), a legal cartel under the Webb-Pomerene Export Trade Act

---

[67] Goldfarb, 4.

[68] As a result of the decision to license more stations in late 1993 and early 1994, the CRTC held regulatory proceeding to consider new applications for authority to distribute programs over cable television in Canada. Canadian station New Country Network (NCN) was granted a license. In June 1994, the CRTC revoked the license of the United States service, CMT at the request of NCN because CMT was a product directly competing with NCN. This decision was opposed by the United States. After the USTR threatened trade sanctions, a commercial agreement was eventually reached.

[69] National Endowment for the Arts, *America in the Making*, 11.

of 1918. The MPEA name was changed to the Motion Picture Association (MPA) in 1994. The MPAA members include Walt Disney Company, Sony Pictures Entertainment Inc., Metro-Goldwyn-Mayer Inc., Paramount Pictures Corporation, Twentieth Century Fox Film Corp., Universal Studios, Inc. and Warner Bros. The MPAA and MPA define their role as to "serve as the voice and advocate of the American motion picture, home video and television industries..." The MPA was created to "re-establish American films in the world market, and to respond to the rising tide of protectionism resulting in barriers aimed at restricting the importation of American films."[70] The MPA has offices in Washington D.C., Brussels, Rome, New Delhi, Rio de Janeiro, Mexico City, Toronto and Jakarta.[71]

Acheson and Maule note that the MPAA has been referred to as a little State Department. (This title is even acknowledged in the MPA's own website.) They demonstrate that the power of this organization is not new. They quote Thomas Guback's 1969 book *The International Film Industry: Western Europe and America*. Guback states:

> its functions, scope, and methods are not unlike those of the Department of State. It maintains an office in the United States as well as an extensive network of offices in key film markets. It negotiates, compromises, threatens and bargains to achieve its objective ... It even has been known to give 'foreign aid' in the form of loans and subsidies and to bolster employment in foreign industries by virtue of American film production in those countries.[72]

The MPA publishes a country-by-country list of Trade Barriers to Exports of U.S. Filmed Entertainment. This comprehensive publication states that for Canada the Investment Canada Act is the most significant barrier to member companies. Other listed barriers concerning Canada include quantitative restrictions in broadcasting, policies with respect to carriage by cable systems and policies that discourage or limit MPA members from acquiring Canadian rights to Canadian productions or from acting as a producer/investor in Canadian productions.[73] The extent to which this report, submitted to the USTR, affects United States policy or foreign countries policies is unclear; however, it seems relatively certain that this organization's lobbying efforts have influenced United States policy.

The MPA's activities have also raised some more specific questions. Although the United States has neither direct quotas nor subsidies at the federal level to protect the domestic industry, succeeding in the United States market has been a challenge for Canadian and other

---

[70] Acheson and Maule, *Millenium Journal of International Studies*, 294.

[71] http://www/mpaa.org/mpaa.html-12/11/97

[72] Acheson and Maule, *Millenium Journal of International Studies*, 294.

[73] MPAA, Trade Barriers to Exports of U.S. Filmed Entertainment, 1995 Report to the United States Trade Representative, 30-35.

foreign countries. The following features of the United States industry have been considered impediments to those attempting to distribute product in the United States market.

- Some have argued that the MPAA rating system for film and video exhibition results in harsher ratings for foreign and independent American films. The fairness of this accusation is difficult to evaluate. MPAA contends that their rating system reflects American values and judges all films according to these values.

- All films distributed in the United States must comply with the Motion Picture Rating System Advertising Code. This measure is not an explicit barrier, but can result in delays when attempting to enter the United States market.

The United States also has a number of tax credits and incentive programs. Many of these are at the state level. These programs are intended to foster attractive environments for the film industry to shoot films, television programs and commercials. While these programs are important in decisions with respect to location shooting, the United States measures do not compare to the array of measures in Canada.

ii) Production

The seven Hollywood film production studios account for 85 per cent of box office film gross revenues worldwide. The seven majors are "multi-national, multi-media, mass-marketing communication complexes with wholly owned distribution operations throughout the world."[74] The seven majors are as follows: Walt Disney, Metro Goldwyn-Mayer/United Artists, Paramount, Sony Pictures Entertainment, Twentieth Century Fox, Universal and Warner Brothers. Each of these studios employs between 2000 and 3000 people.[75] It is important to remember that some of these studios are not American-owned. Sony is Japanese-owned and Universal is Canadian-owned.

There also is an independent motion picture and television industry in the United States. Arthur Andersen Economic Consulting states:

> The independent film industry consists of those companies engaged in the production and/or distribution worldwide in all media of all motion pictures and television programs that are not generated by the recognized major studies. It includes those independent productions, even though distributed by a major studio, in which the producer retains a significant ownership

[74] AFMA website: http://www/afma.com 12/11/97.

[75] Bedore, 18.

interest and is at risk for a significant portion of production costs.[76]

Over 60 per cent of the feature films produced in the United States were made by independents, which generated close to $1.6 billion for the United States economy. The independent sectors of the industry consists of individually financed projects with ownership retained by the producers, who license the property to independent motion picture, home video, and television distributors in each country world wide.[77] The American Film Marketing Association (AFMA), founded in 1908 as a non-profit trade association, represents many of the independents. The AFMA is now compromised of 130 member companies, including ones from the U.K., the European Union, Canada, Australia, New Zealand and the Pacific Rim.

Independents have had success in the United States. Their interests are different than those of the majors. It is the success of these feature films that should be of most interest to Canada. Canada's success in the global film market will be based more on its ability to compete with the independents than the majors. This does not mean that independents can never compete with the majors. *The Full Monty*, a relatively low budget independent film, competed against the majors. However, the *Full Monty* was distributed through Fox Searchlight. Most independents, that have garnered significant success, have done so through a major distributor or a subsidiary of a major distributor.

Some of the cost issues that have concerned the Canadian production industry are also relevant in the United States. The cost of film production has risen dramatically in the United States. In 1988, production and distribution costs from major studio films was on average about $26.5 million; by 1995 this number had almost doubled to $50 million. The cost of recognized talent has increasingly inflated production costs. These higher production costs present a challenge to a country like Canada, where production budgets are on the decline. While budget is not the only factor that determines success, it certainly has an impact on success.

iii) Distribution and Exhibition

The business of licensing movies for exhibition in cinema houses historically has been handled by distributors, many of whom were operated by major film production studios. By the 1930s, the industry in the United States was vertically integrated. Beginning in the 1940s, the Antitrust Division brought a series of cases against the eight major studios alleging various horizontal and vertical violations of the Sherman Antitrust Act. In 1948 Supreme Court *Paramount Decrees* required that five of the major film producers separate their production and distribution activities from their exhibition activities. In response, between 1948 and 1954, Loews (MGM), Paramount, RKO, Twentieth Century Fox and Warner sold off their theaters.[78]

---

[76] AFMA website

[77] Ibid.

[78] Christine Ogan, "The Audience for Foreign Film in the United States," *Journal of Communication*, Autumn 1990, 59.

An Organization for Economic Cooperation and Development (OECD) document explains:

> Those distributors that were vertically integrated were required to divest their theater assets, and some (but not all) were prohibited from re-entering the exhibition business. The decrees also contained certain injunctive provisions intended to prevent discrimination against small, independent exhibitors, and to prevent vertical re-integration by contract. The distributors could not engage in "block booking," or conditioning the licensing of a desired film on the simultaneous licensing of other films, or in other specified types of contractual arrangements that effectively bound a theater or chain of theaters to a distributor....Most of the decrees contained a requirement that defendants license their film 'theater by theater, solely upon the merits without discrimination...'[79]

These decrees remain in effect, but in the intervening half century the entertainment market has changed dramatically. Film distribution has remained moderately concentrated, with eight to ten large distributors existing at any given time. Individual market shares are unstable. The *Paramount Decrees* are not relevant to all distributors; however, all of the big distributors today were Paramount defendants, save Disney, which took over distribution of its own product in the 1950s.[80]

After the *Paramount Decrees*, the United States exhibition industry was characterized by small, independent theater operators. Distributors at this time maintained most of the influence. They often required exhibitors to bid against each other for films. Furthermore, this bidding process was often "blind" exhibitors had to bid without having seen the film. This onerous blind bidding process was made illegal in several states. To counteract the influence of the distributors, the exhibitors instituted the practice of splitting, which is a form of horizontal market allocation, in many markets. By the 1950s, the industry began to change and a few big chains emerged. Splitting eventually was considered a violation of the Sherman Antitrust Act. The practice ceased as a result of criminal suits which occurred in the 1970s.[81]

Despite the end of splitting, the exhibition sector in the United States is highly concentrated: there are few independents today. Furthermore, today there is very little bidding for exhibition rights. It is negotiation that constitutes the preferred method for determining exhibition rights. Moreover, "longer term, formal and informal arrangements between

---

[79] OECD, Horizontal Concentration and Vertical Integration in Cinema and Television Film (Notes by the United States Delegation) Distribution, 11 October, 1995, 2.

[80] Ibid.

[81] Ibid., 3.

distributors and exhibitors are much more common."[82] These arrangements can make it difficult for new entrants. These informal linkages can be perceived as structural impediments to entry. While they do not violate American international trade and investment obligations, they can make it harder for new entrants, which are often foreign competitors, to enter the United States market. Interestingly, this type of informal business practice is what the United States accuses Japan of having – and in the Japan case the United States calls it a trade barrier.

iv) Vertical Integration and Anti-Trust

The trend toward vertical integration among the seven majors began in the mid 1980s. The pace and extent of these mergers since then have been remarkable. The merger and acquisition activity of these seven corporations has involved billions of dollars of debt. The magnitude of the change is demonstrated by the fact that within a very short period of time in late 1995,

> the Walt Disney Co. bought the Capital Cities/ABC television and radio networks for $19 billion (covering 25 percent of U.S. households); Westinghouse bought the CBS television and radio networks for $5.4 billion; and Time-Warner (parent of Warner Brothers studios), which also owns a large television production operation, major book and magazine publishing firms, merged with Turner Broadcasting. The latter would include the huge cable operations of CNN, the Cartoon Network, and TNT.[83]

Some industry sources claim that this current trend constitutes a return to the earlier days when production studios controlled distribution and owned their exhibition networks. Whether or not this new trend actually constitutes a return to past structures, it is certain that both production and distribution of films, entertainment, and information is undergoing a global change. The question remains how will technological changes that increase delivery capacity affect distribution patterns. Technology has created a greater demand for product, which is plentiful in Hollywood. Hollywood's large store of product and existing distribution networks provides it with certain competitive advantages in this new emerging global entertainment industry.

It is these advantages that appear to be increasingly difficult to counter-act for new entrants or smaller independents both within and outside the United States. First, these increasingly vertically integrated companies seem to hold tremendous control of the entertainment market. It is this new level of vertical integration that many perceive as a new barrier to entry. Second, technology has changed the industry. In reality, this process of vertical integration, which is worrisome to those concerned about access to the industry, was in response,

---

[82] Ibid.,3.

[83] Bedore, 20.

at least in part, to the technological changes. Technology requires more investment, and more product. First, keeping up with new technologies can be too costly if not sufficiently capitalized. Second, new modes of distribution, including direct broadcast satellites, has resulted in a huge demand for product. These larger conglomerates seem to better meet the demands of a global communication, information and entertainment age.

It is not impossible to counter the trend of vertical integration. DreamWorks, created in 1995, by three successful Hollywood executives, is an attempt to buck the trend of further vertical integration among the seven majors. While the Canadian challenges are not identical to those of a new entrant in the American market, the success or failure of DreamWorks may reveal important issues related to vertical integration and the challenges it poses to all but the seven majors.

Despite this astounding process of vertical integration, there has been little anti-trust litigation in the United States entertainment industry in recent years. New issues may arise. First, the relevant product market in the movie exhibition business has been first run exhibition. It has been argued that it should include video tape rentals, television movie channels, television pay-per-view, non-movie television entertainment, and some other forms of entertainment. This change in the definition of the relevant product market would reflect a real change in industry characteristics. While box office sales provide an indication of a film's success, these sales no longer are as important as they once were. Currently, 37 per cent of Hollywood's revenues result from home video rental and sales.[84] Second, reconsideration of conditions of entry into movie exhibition may be useful. There may exist structural barriers to establishing a cinema house. Perhaps more importantly, the informal relationship between film distributors and exhibitors could also inhibit entry by new exhibitors in the United States market.[85]

This change in the American industry has even larger consequences in the Canadian exhibition markets. It seems that it creates barriers to entry for distributors that do not have existing informal relations. This issue of access to distribution in both the United States and Canadian markets is central to Canadian film policy. Potential changes, in the United States, as a result of anti-trust, are important therefore for Canadian policy-makers to follow.

The United States market is highly concentrated. The question remains whether this highly concentrated market affects foreign independents differently than United States ones. The question of distribution in the United States is important. Can foreign films enter the United States market with relative ease? Christine Ogan examines a variety of reasons why foreign films were popular in the United States in the 1960s. Her article looks at objective factors, such as industry structure, and subjective factors, such as taste. Acheson and Maule state that "...there is no bias by American audiences against foreign material. In other sectors, American consumers

---

[84] Bedore, 19.

[85] OECD, Horizontal Concentration and Vertical Integration in Cinema and Television Film, 4.

have stampeded to purchase Japanese cars and appliances, Scotch whiskey and Italian designed clothing." They argue "the reason why foreign cultural products do less well in the United States than vice versa is because American products have been relatively more appealing to audiences both inside and outside the United States."[86]

Acheson and Maule recognize that the system of distribution and production is different in the United States. They contend this system can be instructive. However, it seems that the answer is not simply about making better more appealing product, although that is certainly part of the answer. While the world acknowledges that the early Hollywood lead created an undeniable advantage to American studios, it seems less clear what Canada and others can apply from the American experience. The concentrated and powerful American industry has provided American access to distribution that cannot be achieved only by changing the kind of product offered.

This discussion certainly reveals that there is room for good stories that Canadians and others want to hear. Technology only creates more demand for product, not less. These stories need not be produced with expensive *Titanic* budgets. Large production budgets do not guarantee a higher return on capital anywhere. A good independent film, like *The Full Monty*, can succeed in the United States and then the global market, but access to distribution must be made easier. Such access is difficult without using a United States distributor or subsidiary. The answer for Canada, at least in part, lies in rethinking distribution and its relationship to Canada's cultural goals. If our goal is about producing Canadian stories, perhaps we should not worry about who distributes the product, but rather getting the product produced as well as the message of the product into the public domain. This may require more support in training and production. Rethinking distribution policy in Canada may be even more important now that Seagram's has purchased Polygram, including its film distribution unit.

v) Impact of the United States Industry on Canadian Policy

The strength of the United States industry presents challenges to Canada and to Canadian policy-makers. The American strength means that its position at international trade and investment negotiations is unlikely to change. Canada will continue to make the cultural argument even if it modifies its approach significantly. The greatest challenge for Canada is to meet the challenges of a more globalized industry. It is not only the United States that has global vertically integrated players, Canada increasingly does as well. Canada must find a policy approach that enables Canadian films to succeed in the international market and at the same time preserves space for the telling of Canadian stories at home. Only a domestic policy approach that recognizes the difference between cultural and industrial policy will succeed.

At the international level, Canada must determine what is the appropriate level of

---

[86] Keith Acheson and Christopher Maule, *You can't have it both ways*, 9.

flexibility. Overall, Canada supports the multilateral trading system and perceives it as a source of stability and security in commercial transactions. Exporters in the cultural sector need this stability and security just as other industrial sectors need it. At the same time, Canada wants to preserve some flexibility to implement domestic policy that will meet cultural goals within Canada. The question then is how do we get this flexibility. Rules can limit Canada's ability to implement domestic measures. No rules, however, result in uncertainty and thus also limits Canada's ability to implement domestic measures. Given that the United States will continue to oppose cultural protection, given that more and more Canadians seek to export, given that rules create a framework within which to operate, and given that in most other sectors Canada has supported trade-related rules, Canada should seek to negotiate international norms and rules for culture. This process will likely take place at the WTO, so Canada should be ready to take a lead role. Canada has the opportunity to lead the discussion at the WTO, and perhaps to suggest new mechanisms to address the issue of how nations can implement appropriate domestic policy in the area of culture and at the same time implement policies that are not opposed by other trading nations. This does not prevent Canada from negotiating a separate agreement on culture; however, Canada's should not allow this process to divert its energy from the process at the WTO.

BIBLIOGRAPHY

Acheson, Keith and Christopher Maule. *The Culture of Protection and the Protection of Culture – A Canadian Perspective in 1998.* Ottawa: Department of Economics, Carleton University, 1998.

________________. *Canada's Cultural Policies - You can't have it both ways.* Working Papers Series – Carleton Industrial Organization Unit, Department of Economics, Carleton University, Ottawa, 1996.

________________, "Copyright and Related Rights: The International Dimension," *Cultural Developments in an Open Economy- Canadian Journal of Communication*, 19(3/4 Special Issue), 1994.

________________. "Shadows Behind the Scenes: Political Exchange and the Film Industry," *Millenium Journal of International Studies*, 1991, vol. 20, No. 2.

________________ and Elizabeth Filleul. "Folly of Quotas on Films and Television Programmes," *The World Economy*, December 1989, vol. 12, no. 4.

American Film Marketing Association website: *http://www/afma.com*, visited 12/11/97.

Audley, Paul. *Canada's Cultural Industries – Broadcasting, Publishing, Records and Film.* Toronto: James Lorimer & Company, Publishers, 1983.

Bedore, James M. "U.S. Film Industry: How Mergers and Acquisitions are Reshaping Distribution Patterns Worldwide," *Industry, Trade and Technology Review.*

Bernier, Ivan. Cultural Goods and Services in International Law. To be published in *The Culture/Trade Quandary: Canada's Policy Options* (Ottawa: Centre For Trade Policy and Law, forthcoming).

Berton, Pierre. "The Puzzle of Free Trade," in *Why We Act Like Canadians: A Personal Exploration of Our National Character.* Markham, Ontario: McClelland Stewart, 1987.

Canadian Heritage. *A Review of Canadian Feature Film Policy – Discussion Paper*, February 1988.

Crane, David. "Film-rights policy row divides federal cabinet," *The Toronto Star*, September 10, 1996.

Centre for Trade Policy and Law. *Trade Policy Sessions Binder*, 1997.

Department of Canadian Heritage. *Contribution of the Cultural Sector to Employment and Economic Growth,* October 31, 1996.

Dorland, Michael. "Film and Video Production," in *The Cultural Industries in Canada - Problems Policies and Prospects.* Toronto: James Lorimer & Company Ltd., 1996.

Dupuy, Michel. *Statement by Canadian Heritage Minister Michel Dupuy on New Film and Video Tax Credit Measures,* December 12, 1995.

Globerman, Steven. "Foreign Ownership and the Canadian Film Industry," *Canadian Journal of Communications,* Vol. 16, 1991.

Goldfarb, Rebecca. *Canadian Protection and Promotion of Broadcasting: A Public Policy Constrained by Global Realities* (doctoral thesis), November 1997.

Hoskins, Colin and Stuart McFayden. " Telefilm Canada Investment in Feature Films: Empirical Foundations for Public Policy", *Canadian Public Policy,* XXII:2., 1996.

Johnson, Chalmers, ed. *The Industrial Policy Debate.* San Francisco: ICS Press, 1984.

Kessler, Kristen L. "Protecting free trade in audiovisual entertainment: a proposal for counteracting the European Union's trade barriers to the U.S. entertainment industry's exports", *Law and Policy in International Business,* January 1995, col. 26, no. 2.

Magder, Ted. *Canada's Hollywood – The State and Feature Films.* Toronto: University of Toronto Press, 1993.

McFayden, Stuart; Colin Hoskins, Adamm Finn, and Roland Lorimer eds. "Cultural Developments in an Open Economy – Canadian Journal of Communication," 19 (3/4 Special Issue. Burnaby, BC: *Canadian Journal of Communications Corporation,* 1994.

Motion Picture Association (MPA). *Trade Barriers to Exports of U.S. Filmed Entertainment,* 1995 Report to the United States Trade Representative.

Motion Picture Association website: *http://www.mpaa.org/mpaa.html* - visited 12/11/97.

National Endowment for the Arts, *America in the Making.*

OECD, *Horizontal Concentration and Vertical Integration in Cinema and Television Film Distribution* (Notes by the United States Delegation), October 11, 1995, 2.

Ogan, Christine. "The Audience for Foreign Film in the United States," *Journal of Communication,* Autumn 1990.

Paterson, Thomas G. and Dennis Merill. *Major Problems in American Foreign Relations.* Volume II: Since 1914 (fourth edition). Lexington, MA: D.C. Heath and Company, 1995.

Pendukar, Manjunath. *Canadian Dreams & American Control – The Political Economy of the Canadian Film Industry.* Detroit: Wayne State University Press, 1990.

Schector, Barbara. "So long, Cineplex," in *The Financial Post,* November 22, 1997.

Schwanen, Daniel. *A Matter of Choice: Toward a More Creative Canadian Policy on Culture.* Toronto, C.D. Howe Institute, April 1997.

Statistics Canada. *Canada's Culture, Heritage and Identity: A Statistical Perspective 1997 Edition,* catalogue 87-211.

Tamburri, Rosanna. "Canada Considers New Stand Against American Culture" *The Wall Street Journal*, February 4, 1998.

Telefilm Canada, *Factsheet*, January 5, 1998.

Wildman, Steven and Stephen S. Siwek. *International Trade in Films and Television Programs.* Cambridge, MA: Ballinger Publishing Company, 1988.